

## **CHAPTER 5: OWNERSHIP AND ORGANIZATION CHANGES [7 CFR 3560.405]**

### **5.1 INTRODUCTION**

During the term of an Agency loan, changing circumstances may lead borrowers to seek Agency approval of a change in the structure of the ownership entity. For instance, partnerships may dissolve, or substitute individuals or entities may obtain an ownership interest in a property due to business reorganizations, retirements, or other reasons. In order to address these situations, the Agency has developed requirements and procedures for receiving notification of and reviewing proposed changes, as well as granting approval for such changes to ensure that the Agency's security interest is protected.

This chapter covers the Agency's requirements regarding changes in a borrower's ownership structure and Agency procedures for reviewing and accepting such changes.

### **SECTION 1: NOTIFICATION OF CHANGES TO BORROWER ENTITY**

### **5.2 OVERVIEW**

Borrowers must report to the Agency all changes to the ownership entity. There are two broad classes of changes—those that require prior Agency consent and those that do not. Minor changes that do not affect the Agency's security interest (e.g., an increase in one limited partner's ownership interest from 30 percent to 60 percent, or a change of limited partners do not require prior Agency consent and may simply be reported to the Agency at the time they occur). Reporting such changes helps promote effective Agency oversight by ensuring that the Agency will always know who to contact with program information or questions about the property. A major change that could affect the Agency's security interest in the property (e.g., changes in the individual's exercising or controlling interest in the property, such as addition or change of a general partner or change of general partner composition), on the other hand, requires that the borrower entity request and obtain prior Agency consent. The Agency may grant its consent if those proposed to hold a controlling interest in the property evidence credentials expected of eligible applicants (e.g., adequate management experience to successfully provide ownership oversight).

This section covers ownership changes that simply require Agency notification, but not prior Agency consent. Changes that require prior Agency consent and the Agency's criteria and procedures for approval of such changes are addressed in Section 2 of this chapter.

### 5.3 NOTIFICATION OF CHANGES WHEN CHANGES HAVE OCCURRED

#### A. Changes Requiring Notification

Borrowers must notify the Agency of all changes to the organizational structure or ownership interest in the borrower entity, even if Agency consent was not required to effect the change. Such notification should occur as soon as the changes are completed.

Although Agency consent is not required for membership changes involving borrowers that are nonprofit corporations or nonprofit organizations of farmworkers, they still must be reported to the Agency if they have occurred. The Agency will track these organizations to ensure that they maintain the number and type of members required by their articles of incorporation and bylaws.

#### B. Required Content Of Notification

The notification must describe changes in the organizational structure of the borrower entity and contain the information listed in Exhibit 5-1.

##### Exhibit 5-1

##### Required Content for Borrower Notice of Changes in Ownership Entity

- The names and addresses and percentage of ownership of the individuals that comprise the borrower entity;
- A summary of the changes in percentage of ownership among members of the borrower entity;
- Amended organizational documents reflecting the changes;
- An opinion from the borrower's attorney stating that the changes are in accordance with preapproved organization documents, are permitted by law, and comply with Agency regulations; and
- A description of any membership changes that occurred.

If no changes have occurred, borrowers must submit a certification at least annually that no changes have been made.

#### C. Submission of Notice

The certification of no changes may be submitted at the end of the fiscal year for each project in conjunction with the Annual Audit (or Special Engagement Report) submission. As such, this requirement imposes no new or additional burden on borrowers or the Agency.

Updated ownership organizational documents also must be submitted when changes have occurred.

#### **D. Agency Review of Notice**

Loan Servicers must review the notice to confirm that any changes in borrower entity did not require Agency consent. In making this determination, Loan Servicers should pay particularly close attention to the description of the changes and the opinion of the borrower's attorney. If there is any doubt about the acceptability of the changes, the notice, along with any other pertinent materials, should be sent to OGC for review.

It should be noted that the cost of the opinion of the borrower's attorney must be paid from nonprofit funds as such opinions are a borrower expense, not a project expense.

If the Loan Servicer determines that the changes are acceptable, the information about the borrower entity should be updated in the project case file and in the Agency's automated tracking systems.

All nonprofit borrowers must maintain the minimum required number of members. If the review of the notice reveals that the minimum number of required members in an organization has fallen below that prescribed by organizational documents, Loan Servicers must provide the State Director with a report of the circumstances, including the organization's plan for obtaining additional membership and a plan for continued operation of the project. The State Director will review the report and provide Loan Servicers with instructions for servicing the account.

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## **SECTION 2: CHANGES IN BORROWER ENTITY REQUIRING AGENCY CONSENT**

### **5.4 OVERVIEW OF CHANGES REQUIRING AGENCY CONSENT**

The Agency imposes specific requirements on certain proposed changes in the structure of the borrower entity to ensure the adequacy of the new or substitute interests and thus protect the interests of tenants and the Government.

The Agency requires that borrowers obtain Agency consent to organizational changes involving the controlling interests of the borrower entity in order to ensure that such changes will continue to serve the needs of tenants and protect the Government's interest. For example, if one partner in a borrower entity decides to sell his/her interest to a new individual from outside the existing organizational structure, the Agency needs to review that individual's prior history and qualifications to ensure that the person is eligible to participate in the program (i.e., is not under suspension, debarred, under OIG review, or known to be in default on any Agency loan[s]). The purpose of this review is to evaluate that the borrower entity will continue to be eligible under program requirements and that any changes in the organizational structure do not adversely affect the Agency's security interests.

These requirements regarding changes in the organizational structure of the borrower entity apply to transfers of ownership interest totaling less than 100 percent in any 12-month period. In contrast, if 100 percent of the ownership interest in the borrower entity is transferred to new individuals or organizations during any 12-month period, this change is considered a project transfer. The requirements and procedures for project transfers are addressed in Chapter 7.

### **5.5 REQUIREMENTS FOR OBTAINING AGENCY CONSENT**

#### **A. Overview**

Certain changes in the structure and ownership interests in the borrower entity require Agency consent before they become effective. These include:

- Any changes in the controlling interests of the borrower entity; or
- Changes in the ownership interests of the borrower entity that involve the transfer of stock to any individual or organization not previously listed in the ownership documents submitted to the Agency.

Examples of such changes include changes in general partners, addition of new general partners, proprietorship as a result of death, divorce, or other applicable ownership changes.

## B. Written Request

Requests for Agency consent to organizational changes must be submitted in writing, along with *RD Form 465-1, Application for Partial Release, Subordination, or Consent*, to the Servicing Office. Each request must describe the proposed changes in the organizational structure of the borrower entity and list the information shown in Exhibit 5-2 for each new or substitute ownership interest or member in the borrower entity.

The information included with the written request must demonstrate that the proposed change will not adversely affect the Agency's security interest in the property by illustrating that all key individuals would meet loan approval requirements.

### Exhibit 5-2

#### Required Content of Requests for Agency Consent to Changes in Borrower Entity

- *RD Form 465-1, Application for Partial Release, Subordination, or Consent*;
- The names, addresses, and taxpayer identification numbers of individuals with controlling interests in the new or substitute entity;
- Certification that the new interests and/or members are not suspended, debarred, or in default on Agency loan(s);
- The organizational role of the new interest/member or changes in roles of existing individuals;
- Resume, including experience managing real estate, business experience, and education;
- Personal financial statement;
- Percentage of ownership of the new interest/members in the borrower entity;
- Proposed amendments to organizational documents;
- Previous participation certification; and
- Opinion of the borrower's attorney stating that the changes are in accordance with reapproved organizational documents, are permitted by law, and comply with Agency regulations.

## C. Assumption of All Applicable Responsibilities By New Interests

If any portion of the controlling interest in the borrower entity is transferred to an individual or organization not previously holding a controlling interest, the new individual or organization must agree to assume the responsibilities and obligations established under the terms of the promissory note with the Agency, the mortgage, the loan agreement/resolution, and any applicable partnership documents for the entity.

#### **D. Assumption of Liability By Substitute General Partner**

In the case of substitution of any general partner, the substitute general partner must agree to assume the responsibilities and obligations of the original general partner under the terms of the Agency promissory note, mortgage, and the borrower's partnership agreement.

In consultation with OGC, the State Director may require the substitute partner to sign an agreement to assume all applicable liabilities. This agreement then is placed in the case file.

#### **E. Satisfaction Of Eligibility Requirements**

All proposed new individuals in the ownership entity must meet applicable eligibility requirements for borrowers under 7 CFR 3560.55. For further information on eligibility requirements, see Chapter 5 of the Loan Origination Handbook.

### **5.6 BORROWER REQUESTS FOR CONSENT**

Borrowers must submit their written requests for Agency consent to organizational changes at least 45 days prior to the desired effective date of the change. Borrower requests must contain the information listed in Exhibit 5-2.

### **5.7 AGENCY REVIEW OF BORROWER REQUESTS**

#### **A. Overview**

In order to ensure that all changes to borrower entities protect the interests of tenants and the Government, the Agency has developed procedures for review and approval of proposed changes. By preventing changes that do not further program objectives, the review process ensures that the program is implemented consistent with Agency mandates.

Loan Servicers need to take all actions necessary to determine that the changes will have no adverse impact on the loan or property. These actions will vary based on the nature of the changes to the borrower entity.

The Agency may reject such requests if the borrower fails to adequately demonstrate that the proposed change will not adversely affect the interests of the Agency or the tenants of the property.

#### **B. Loan Servicer Actions**

Loan Servicers first review borrower submissions for completeness. Next, they perform a review to determine whether the new individuals or organizations proposed meet eligibility criteria (i.e., the same criteria required to qualify for a new Agency loan as set forth in the Loan Origination Handbook). To determine that approval of the transaction will not adversely affect the objectives of the loan or the property, the State

Director must consider past performance, experience, qualifications, and abilities of any individual or organization obtaining an interest in the borrower organization. Finally, Loan Servicers review all documentation to determine if the substitute general partners propose to assume all liability that had been assumed by the withdrawing entity.

When the initial review has been completed, Loan Servicers process and submit *RD Form 465-1, Application for Partial Release, Subordination, or Consent*, to the State Director, who either approves or disapproves the proposed transfers or changes. In cases where proposed membership changes are not covered in the organizational documents, or appear to be in conflict with applicable regulatory requirements, Loan Servicers may submit case files to OGC for review and concurrence regarding a borrower's legal sufficiency to assume the proposed role in the new organization. OGC does not override the decisions made by the Loan Servicer with regard to organizational changes.

## **5.8 DOCUMENTATION OF CHANGES**

In order to ensure that there is a running history of all changes made to the organization of a borrower entity, the Agency requires that all changes be adequately documented through both written notification to borrowers and maintenance of case files. Loan Servicers must respond to all requests for Agency consent to changes in a formal letter, a copy of which is placed in the borrower's case file. Documentation allows the Agency to track the legality of the changes and the suitability of any new individuals or organizations added to the borrower entity over time. All changes must be entered into MFIS so that the automated system is always up-to-date.